School of Economics and Management

TECHNICAL UNIVERSITY OF LISBON

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# *Market Solutions in Poverty: The Role of Microcredit in Development Countries with Financial Restrictions*

WP 12/2009/DE/UECE

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WORKING PAPERS

ISSN Nº 0874-4548

# MARKET SOLUTIONS IN POVERTY: THE ROLE OF MICROCREDIT IN DEVELOPMENT COUNTRIES WITH FINANTIAL RESTRICTIONS

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## Abstract

The creation of credit markets in poor countries is a crucial factor for their development. If well put into practice, people would be able to improve their quality of life. With the suitable support they will become educated and that will allow them to enlarge their business, to think by themselves and to appreciate that they have rights. Microfinance has seen great changes in the last 50 years and has become visibly known due to the success of some occurrence in developing countries and more recently in Europe through a number of schemes that have been implemented solving this key issue. In this article we discuss this experience, we evaluate the economic theory of microfinance and propose a alternative model. We conclude that microcredit can be see as a new approach in developing policies or as a scheme against unemployment.

Keywords: microfinance, microcredit, rate of interest, development, poverty, money.
JEL: D7,D8,G19, O23

## Introduction

People with more financial resources than the rest of the population make use of their local knowledge of individuals or money lender, but formal credit is not widely available for people who need to find funds for their economical activities. Millions of people of the world's population does not have access to financial services from formal institutions, either for credit or for savings. Among them, certainly, are nearly all the poor of the developing world. The traditional explaining argument is that there is a high rate of default and there is a high cost of screening loan applicants and pursuing delinquent borrowers (Stiglitz, 1990).

In a developed society the use of credit is so common that most of us do not realize how many people do not have access to it. We see credit being advertised not only for business, but also very often for holidays, cars, and so on. Of course one can argue that banks are not ignorant and they will extend credit only when repayment is possible, and when is secure with collateral. Basically, banks concede credit when profit is expected. What if lending to poor people, not £50,000 but £50 also creates profit for the bank? What if, against the majority of mainstream thought, the poor repay their installments?

The creation of credit markets in poor countries is a crucial factor for their development. If well implemented, people would be able to sell their products, pay a fair interest rate, and use the extra money to improve their quality of life. With the appropriate help they will become educated and that will allow them to expand their business, to think by themselves and to realize that they have rights. The definition of what well implemented and an appropriate help *is*, is of course, a matter for debate.

The main goal of this essay is to focus on the importance of credit markets on the poverty elimination process as a market solution in alternative to more social, political or ideological approach. Not only as a more effective process but as economical one in a more democratic developed world. We will start by exposing some important facts about microcredit in Section 1, analyzing alternative method of microfinance praxis and re-examine them, through experience. Section 2 will look at the shift from an ideology based on subsidies and aid, to a more free-market orientated theory that has become increasingly important. Section 3 will focus on the microeconomics of the microcredit that has been developed since the middle eighties, focusing on joint liability, moral hazard, adverse selection, auditing costs, and enforcement issues, searching a right model to guide to policy orientation of microcredit. We demonstrate in a simple model, that a group orientation approach is more adequate than an individual form considering policy recommendations. We will summarize the points that are the most important in the group and individual lending process. In Section 4 we will talk about some social and political issues aspects to be considered like the importance of women, savings and Non-Governmental Organizations (NGOs). Section 5 we will show some of the European and American examples of financial support. Finally, Section 6 will be the conclusion.

## 1 - The important facts of Microcredit

The combat against the lack of credit markets and thus against the high interest rates demanded by the money-lenders is not new[i]. Money-lenders use the power of information about potential borrowers and demand different rates from different people. Usually the poorer one was more one would have pay. Since the fifties, Governments realized that a large number of people did not have any other choice than being dominated by those monopolists. As such, programs were implemented in which governments and subsidized credit delivery to small farmers in many developing countries. Development finance institutions and international donors were responsible for the delivery of cheap credit to poor farmers (Johnson and Rogaly, 1997). Nevertheless the difficulty in monitoring the application of the credit, the dependence on the donors, the poor investment decisions and low repayment rates made these programs unsustainable. In the late seventies a new approach towards the private initiative started to gain importance.

The growing importance of the role of microcredit in the eradication of poverty reflects the recent success of small-scale lending programs. In the early 1990's several institutions came together to make possible the reproduction of such experience to other countries[1]. These programs relay on lending to small enterprises, distribution, crafts, trading and agriculture, etc. The participatory nature of these projects, together with the emphasis on women entrepreneurs and job creation have raised hopes of reducing poverty through this approach.

Over the past decade, microfinance institutions have succeed, in providing credit and savings services to the entrepreneurial poor, through innovative strategies. These include the provision of small loans to poor people, especially in rural areas, at full cost interest rates, without collateral. But, there is some critical opinion about this experience that is necessary to explain. Harper (1998) noted that it is not self-sustaining in the sense of covering all its costs; he argues that it might be difficult to implement in situations without such a homogeneous society; clients' savings only contribute less than a third of the funds required for loans; this model demands a great deal of staff time and time of clients, which can be costly. Schmidt and Zeitinger (1998) sustain that such a bank does not impose any penalties whatsoever on a group if one of its members is either unable or unwilling to pay, and that the bank chooses not to exploit the potential of the group as a means of enforcing group liability.

In this sense, the contribution of some organizations to the microfinance movement, begin to demonstrates, for example, that the experience of creation of small loans could substitute the physical collateral, nonexistent in poor people, by social collateral through the joint liability of the borrowers, i.e. by the joint responsibility of repayment on any loan concede to any member of the group. This is an attempt to lower screening costs by using local insider information about the creditworthiness of borrowers, and about the real use of the credit (Johnson and Rogaly, 1997), in order to avoid adverse selection and moral hazard problems. The adverse selection problem occurs because it is not possible to know precisely the effort that each member will make to repay the loan and thus the bank cannot distinguish between good borrowers and potential defaulters. The self-selection method means that this information, unknown to the bank, is now

[1] Currently there are about 3000 microfinance institutions in developing countries.

given through the group formation, since no member will choose a partner that will clearly default on their repayments. The moral hazard problem occurs when it is not possible, or too expensive to monitor the activity for which a borrower is using a loan. This is now overcome by the fact that each member has an incentive to monitor the others' activities in order to avoid that a loan misused by another will create an extra payment responsibility on them ( Junus, 1998)[2]. The group is ultimately responsible for repayment if the individual defaults[3].

2 - From a top-down to a bottom-up approach

The lack of credit availability implies that poor people borrow from money lenders at very high of interest per year, but they are generally doing so to meet short-term consumption needs, not to make long-term productive investments (Morduch, 1998).

Poor people may not have access to formal credit markets because banks face high transactions costs per loan when lending at small scales; it is very difficult to determine the risk of potential borrowers and also monitoring the application of the loan when the clients are poor; they won't be able to pay for the full cost of the lending process; they won't be able to create savings to continue their activity but instead will spend the loan on consumption; the nonexistence of collateral does not create any pressure on the borrowers to repay. Nevertheless, it was recognized that households could generate returns if they first had a chance of credit that could be used in expanding their business.

The donors, recognizing the social mission of the programs, would promote the supply of lending at rates well below market clearing. The rates charged would not cover the costs involved.

In the late 60's serious problems with these programs became evident as their implementation costs were quite large and the rates of default were immense (Robinson, 1998). Also, these credit subsidies tended to encourage corruption, and a big portion of the loans available ended up with well-off politically connected entrepreneurs rather than poor households (Morduch, 1998). This subsidized method had a lack of financial discipline.

The new bottom-up approach reflects the shift from government-subsidized credit delivery to a profitable financial intermediation at the local level. Giving the difficulty of sustaining credit institutions, new mechanisms were implemented. The physical collateral problem was substituted by contractual innovations like the joint liability and by using dynamic incentives. The discovery of the joint liability method was very important since it can also reduce expected audit costs and improve efficiency (Ghatak et al, 1998). The intention is that if group members face lower costs of verifying each other's output, than the bank can avoid the cost of auditing.

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[2] "The Grameen bank in Bangladesh has created 1084 branches, with 12 500 staff serving 2.1 million borrowers in 37000 villages. On any working day Grameen collects an average of $1.5 million in weekly installments. Of the borrowers, 94% are women and over 98% of the loans are paid back. Grameen methods are applied in projects in 58 countries including the US, Canada, France, The Netherlands and Norway

[3] This joint liability model is achieved by the self-selection of five elements with similar economic backgrounds (there are male and female groups) and each of them has to save 1 taka per week. Loans are made to two members at a time and must be repaid in equal installments over 50 weeks.

A repayment rate above 90% was achieved in certain cases (Morduch, 1998).
The new approach claims that the poor can repay fair annual rates or even more, since they want to avoid the traditional money lenders, and thus fully covering the costs. It is also believed that poor people do save whenever possible. Given certain macroeconomic, political and regulatory conditions, this theory defends that commercial institutions can supply credit and savings facilities and intermediate profitably without subsidy. They claim that only sustainable financial institutions can meet the demand for institutional microfinance since there are not enough donor and government funds to meet a significant proportion of the worldwide demand.
Considering Portugal as a case where the movement in favor of microcredit has gained importance, showed by the creation, in 1999, of the National Association for Credit Rights (ANDC) and considering that those who are apart of the economic activity are more than a million, and for a lot of them (10 to 15%), the auto-job creation trough microcredit is the merely way to get out of this vicious cycle.[4] As a matter of fact, this association has the support of the Employment Institute (part of the government) through subsidies that are used to manage the association, and has also set partnerships with one of the biggest Portuguese bank BCP/Nova Rede, that lends the money of the small loans conceded. In 2001, this association lent about 325 000 € in 70 loans, which implied the creation of around 100 working places. The loans are given for a period of 3 years, with a maximum value of 5000 €, with monthly payments at Euribor plus 2% of interest rate.
The ANDC works with the local associations that indicate candidates that already have some idea about what they would like to implement. These candidates will be interviewed latter by the ANDC where the projects and the personality will be evaluated. During the next step the candidate will be evaluated by a board of experts in the ANDC, which will decide if the project should pass to the next stage. The final decision belongs to the bank BCP[5].
This association lends money to private individuals that do not have access to the formal market. The members of ANDC say that a group strategy would need more human resources, since in a city the definitions of per pressure group are not so strong as in other regions or countries.
The association also has a fund that represents 5% from all the loans conceded. From the entire loan conceded, around 15% were not repaid. In these cases the association is responsible for 50% of the debt, and BCP/Nova Rede responds for the other 50%. ANDC believes that this approach will become even more known, and the success will depend on the spread through mouth from successful examples. BCP Bank has a crucial role in this process. This bank has also created, together with other European banks, a new credit Institution - NovoBanco - in Mozambique,

[4] Micro-crédito, combate á exclusão - National Association for Credit Rights, Lisbon, 2000.

[5] During 2000 there were 301 people interested in having a loan, 165 were rejected by the ANCD and only 7 by the BCP. The loans conceded belong 42% to male and 58% to female, with 62% of the loans given to people between 25 and 44 years old. The average loan is around 3500 €, mostly used in activities relates with restaurants, restoration and commerce.

which is totally dedicated to conceding credit to those poor people that were unable to get it in a formal market, but that are capable of paying the installments. Is also involved in the creation of a new bank in Mozambique, whose main activity will be microcredit.

From this example we can see that the group loans are very difficult to implement when the organizations involved do not have enough human resources to implement the monitorization and educational programs in an urban environment. In this example the borrower has one ANDC element that checks the evolution of the activity not only has a way of pressure but also as a mean of transmission of management knowledge.

Of course discussion about which method to implement is intense. Should a group or individual-based lending be used? Should savings facilities be implemented? Should NGOs be transformed into banks or should they find a social role and leave the business of credit to the private institutions? Is the financial community convinced that microcredit is profitable? We will try to answer some of these questions.

## 3 - Group based vs. Individual based lending model

### 3.1. - The Field's Evidence

From what we could see so far, it is possible to use a solidarity-group lending scheme as a way of making use of the social collateral. Because members are jointly liable for each other's loans when one is having payment difficulties all the others create peer pressure. In some circumstance the group, as a whole may repay the loan. This technique is a way of filtering those who really need credit and a way of monitoring borrowers' activities. It transfers risk from the bank to the borrowers. The fact that these schemes imply regular compulsory group meetings, seen by some as extremely costly, may discourage those better off. The openness of the meetings together with the accountability for repayments may prevent colluding between members and staff over the allocation of credit. In the same way the social pressure may ensure the payments. Of course when groups are formed by self-selection, this is an indirect way of obtaining information about the character of the borrowers.

On the other hand, besides this group lending in some banks, there is some dedicated solely to individual loans. The use of groups intends to overcome the necessity of collateral. With an individual loan, usually a kind of collateral is asked before conceding the loan. Borrowers are asked to pledge assets that are relatively easy to obtain for the borrower but would be very difficult and expensive to replace in case they were seized. Also, a commercial approach is used towards the borrower and staff: prizes and competitions for the borrowers and performance bonuses for the staff (Harper, 1998).

The success of this method relies on the following factors: the spread between interest rates is large enough to cover all financial costs and to return a profit; the knowledge of the local market; unique type of loan available (Kupedes); commercial approach towards the staff; intense staff training; good management and regulatory environment[6].

Nevertheless the evidence on the field shows much more confidence in group-based theories. The individual approach gives rise to specific risks and administrative costs that the lender has to minimize. The group-based implies that the lending institutions can avoid incurring those risks by using the group pressure and by shifting a big part of the administrative costs to the borrowers. It is not surprising that the later has been used more widely by new credit institutions and by NGOs.

3.2. - Microeconomics of credit market in poor countries

One way to solve the nonexistence of collateral among poor people is by forming groups in which each individual is responsible for each other's repayments and in which a loan is only conceded if the previous installments have been paid on time. This is usually called *peer monitoring,* in these circumstances there is a transfer of risk from the bank to the cosigner: with group lending, if one element does not pay, the whole group will suffer. Does this transfer of risk improve the borrowers' welfare? What are the implications of having different information about the borrowers and about the kind of credit market that exists? The following topics will review these issues.

3.2.1. - Peer monitoring: transfer of risk from the bank to the cosigner. Does this risk transfer improve the borrower's welfare?

Stiglitz (1990) developed a model in which the lender offers a contract to a group of two neighbors and each should monitor the kind of project that the other is implementing. If one neighbour (cosigner) agrees to cosign for the other borrower, he can obtain a lower interest rate and additional funds as a way of compensation for that additional risk. The cosigner agrees to pay a percentage (R) of the initial loan to the lender if that loan goes into default. The cosigners expected utility depends on the type of project undertaken by his neighbor, since a risky project implies an inferior probability of success and thus a grater chance of default. The conclusion achieved is that at low levels of (R) the risk burden imposed on the borrower is exactly compensated by the reduction in the competitive interest charged. Stiglitz concluded that peer monitoring improves the borrower's welfare in the sense that he has access to a greater quantity of lending at lower than in an individual based approach.

3.2.2. - Does social pressure improve the repayment rate of the borrowers?

Basley and Coate (1995) argue that the key feature of group lending is joint liability. They model the borrowers' behavior by specifying a repayment game in order to analyze the borrowers' willingness to pay after some set of project returns has been realized.

[6] Malcom Harper tells the story of a borrower, who two days after he had gone to the BRI unit asking for credit was visited by a credit officer to get more information about his business. This officer was also planning to speak with the village officer who could vouch for the borrowers' character. This shows a tight control. The advantages of this method is that it implies lower transaction costs. This enables the officer (usually responsible for the entire loan process), to develop a quasi-personal relationship with the borrower, which gives access to significantly more information about clients and their business over time (Schmidt and Zeitinger, 1998).

In an individual lending situation, a bank lends to the borrower one unit of capital to undertake the project. After the project is realized the borrower has to decide whether to repay the loan and the interest (L) or not. This decision will be the result of a comparison between the gain of consuming that extra amount with the consequences of default since the bank imposes a penalty (P) in this case. The borrower will only repay if $P \geq L$. The authors conclude that the repayment rate is decreasing in L. Also assuming that the bank cannot enforce the repayment for every project return, and that the borrower would fail to repay his loan if his project return was very low, they concluded that repayment rate is less than 100% for all positive rates.
They demonstrate that the group lending approach improves repayment rates. One of the borrowers may repay the total loan himself if he believes that the other will default. But if the latter realizes that, then he has no incentive to pay his share. The authors develop the implied repayment game and conclude that group lending has a higher repayments rate when interest rates are low. As they are allowed to increase, individual lending has a better performance in terms of repayment.
What are the consequences of the repayment rate when we add social sanctions in case of default? The authors believe that individuals can affect each other's payoffs since contributing members can impose social penalties on the other. The authors concluded that an increase in social sanctions tends to reduce the negative effects of group lending on the repayment rate without damaging its positive aspects. Thus if social penalties are severe enough group lending will result in a higher repayment rate than individual lending. Ghatak (1980) also adds that by increasing the threat of punishment a partner induces the borrower to undertake safer projects.

3.2.3. - How does group-lending approach help to combat inefficiencies in the credit markets?

Armendariz and Gollier (1996) analyze the importance of different kinds of information about the borrowers on the improvement of the credit markets, by its importance in lowering the interest rates.
They begin with a basic model of individual lending. The bank cannot distinguish between the safe and risky borrowers and the only information known is that there are $\pi$ safe borrowers and 1- $\pi$ proportion of risky borrowers. This is a case of asymmetric information.
Three possible interest rates can be charged depending on different situations. When only safe borrowers apply for a loan a certain rate will be charged. When both types apply the break-even rate will be higher in order to compensate for those risky individuals that will not repay the loan, finally if only risky borrowers are interested then that rate will be even higher.
If the bank anticipates that all types will apply, the middle rate will be charged and both types will be better off by undertaking the project. Nevertheless inefficiencies can arise when there is either a shortage or an excess of credit. In the former the middle rate is charged due to the fact

that the risky elements trigger higher interest rates that will drive out the safe borrowers. In the latter safe borrowers are subsidizing the inefficient risky projects. This article defends that peer monitoring is a way of solving this problem of adverse selection.

Armendariz and Gollier assume that borrowers don't have any collateral to begin with and that in a peer group situation groups have only two members. The bank requests that potential borrowers form pairs and each individual will have to repay the share of his defaulting peer, or else both borrowers will be excluded from future lending. They intended to show that even when individuals don't know each other, the peer grouping method still improves the inefficiencies of credit markets, and thus it can be successfully used in the urban environment.

When the borrowers have complete information about each other, there will be no conflict between pairs since safe borrowers will want to be with the same type and not incur unnecessary risks. Where only safe pairs apply for a loan, the bank does not have any default problem. Thus with complete information about the peers, the projects that are socially inefficient under standard credit contracts will not take place under peer grouping, and that the socially efficient will always persist under the latter modality. Banks using this method obtain information about the individuals.

In a pooling situation, where safe borrowers match with safe and risky with risky, the banks cannot distinguish between the pairs. In fact, the risk increases since the joint liability clause is less effective in the risky pairs. They conclude that when agents know each other's type there will always be projects that being socially efficient, will not be undertaken with standard contracts but will be part of the equilibrium in a pooling situation under the peer grouping method. As Ghatak et al. (1998) say, group formation with an assortative matching process allows banks to screen borrowers by the "company they keep". If the bank offers two contracts, one with high joint liability and lower rates and the other with low joint liability and high rates, safe borrowers would choose the former contract and risky borrowers the latter. Thus repayment rate and efficiency are higher under joint liability contracts.

When the borrowers do not have complete information about each other they will have to pair randomly. When only safe borrowers are willing to form pairs, a peer-grouping device cannot solve the inefficiencies arising in credit markets with imperfect information.

In a pooling situation in which both types are interested in having a loan they concluded that if the return generated by the safe borrower is high enough to repay for the other borrower's default, peer grouping does not solve the inefficiencies of credit rationing. But if the return of the safe individual is not large enough to repay their defaulting pears, part of the risk is effectively transferred to the risk borrowers via an increase in break-even rate, and the problem with inefficient credit rationing is solved. This method can than be used in situations is which the peers don't have information about each other.

3.2.4. - Problems with Joint-liability

If the projects are uncorrelated, an increase in the number of members improves the effectiveness of joint-liability, as the projects are now diversified. Nevertheless if the group is too big, then there is a risk of free riding in monitoring and auditing.

Experience has shown that very large groups are difficult to manage and that the small group approach is more efficient (Ghatak, 1998). Another issue concerns to the degree of interaction and knowledge of each member. Armendariz and Gollier claim that even in urban areas these schemes can be successfully implemented. Ghatak on the other hand sees this difference in information between individuals as quite important. What appears to be common is that groups should be self-selected and not imposed.

The social requirements that joint-liability imposes might also be difficult to obtain in every part of the world. In areas where different races and religions coexist those kind of social pressures do not have the immediate expected result. It also implies that when someone defaults the other members will sanction those in default. In fact, in some situations, the group might feel a discomfort in penalizing those who did not repay the loan. On the other hand the extreme reaction of violence towards the defaulting member can happen. These issues should be taken into account when a scheme of this nature is being implemented.

3.2.5. A synthesizing alternative Model

The different models before exposed diverge in the solution of the best method to approach the array. We will try a first attempt solution by taking into account the two different approaches that lead the theoretical analysis, group versus individual loan. Bank A has as its strategy the maximization of its income R, using a capital C, and knowing that it concedes credit Cp to a group people, at a interest rate i, for t time. The income can be expressed as R = f (i,s), where s accounts for other net benefits of the bank (we eliminate the transaction costs). Thus R is:

$$\int idt + \int sdt = R \quad (1)$$

The group B has as its strategy the maximization of its income S with a capital Cp obtained thought a loan, for which will have to pay r of interest at the end of the period t. S can be expressed as S = f ( K,W) where K accounts for the productive factors, W the total amount of work applied in the project, all financed by Cp. The group has a cost r, w and a penalty f, which will decrease w in case r + Cp is not paid. The group's income will be:

$$\int (K+W)dt - \int (r+(w-f))dt = S \quad (2)$$

The probability of R is $\theta_1$, which depends on the probability of S i.e. $\theta_2$, hence $\theta_1$= f($\theta_2$) and f($\theta_2$)= $\theta_2$. If f has a probability of zero, than B does not fulfill the deal, and we are dealing with a strategic cooperative min/max game. All the economic agents fulfill the min/max condition when i = ± r, Cp= ± (K + W), and

$$\int idt + \int sdt = \int (K+W)dt - \int (r+(w-f)dt = 0 \quad (3)$$

The solution is found when all projects are finished within period t. Equation (3) finds the solution, which confirms the economic assumptions that the agents defend their interests, their benefits and when the condition (3) is accomplished R and T are at their maximum. This implies that the certainty about the return on the loan, does not depend only on monitoring, but also depends on $\int (K+W)dt$ = $\int PQ - C(Qf(Q))$, where PQ are the income o the sale of the product B, and C are the costs. On the other hand, this also means that, $\int PQ - C(Qf(Q))$ ≥ $\int idt$, will only have development if $\int PQ - C(Qf(Q))$ > $\int idt$, otherwise we have a situation where savings where not possible to be made. Thus, one of the conditions for the success of the project is that i > r, which will depend on the joint monitoring between the members of the group, that allows for the elimination of great part of the transaction costs, decrease the risk and contribute to the decrease of the average interest rate in the long run, depending only from the global monetary policy.

It is clear enough that there is much more empathy with the group lending approach both in theory and in practical situations. From the theory and experiences on the field the main common factors on the group-lending process are: Joint liability solves the collateral, moral hazard, adverse selection, auditing and monitoring costs; Group-formation is more successful when is based on a self-selection process; Groups with homogenous backgrounds are preferable to greater variety. Within homogeneous groups, is desirable that the projects implemented by each member are uncorrelated, the rules of the scheme should not be suddenly changed.

If borrowers are not limited to a number of loans, there is a high probability that the default rate will be very high. In this case, it is preferable to have a clause that says the credit will be denied in some specific situations.

A small number of members is preferable, due to the free-rider problem and also due to the difficulty in paying attention to each individual. It is also a good idea to let the group decide about the number of their members. It gives him the knowledge of the administrative procedures, but also promotes his self-esteem and his importance for the group.

## 4 – Some Social and Political Issues related with Microcredit

### 4.1. - Credible Social Organization for group lending

The issue of group lending has been strongly discussed[7]. It was considered that the major issues on this subject were the target group, group formation and savings and lending operations. In situations where the project was open to other people than those defined as the target, the groups tended to become heterogeneous and this often weakened the group solidarity. As such homogeneous groups are encouraged.

[7] Workshop entitled *Group-Based Savings and Credit* that took place in Bangladesh in 1983, where Bangladesh, India, Nepal, Pakistan, Philippines, Sri Lanka, Thailand and United Nations agencies.

It was concluded that the size of the group should be decided by their own members and realized that the nature of the economic activity has influence on the effective and desirable size of the group. The role of a member of the organization in coordinating the self-group formation mechanism was also viewed as very important. They also realized that all country experiences showed that the poor can and do save and that savings are an important factor to de development of these societies. The rates charged were lower than those of the money-lenders but high enough to cover costs of lending. They admitted that subsidized rates were not recommendable in the long run.

4. 2. - A special case: the women participation

Women have been neglected in the importance that they have on the running of the household. In the beginning of the nineties it was estimated that women headed 20% of all households in the world, this number can increase through the time (Fong et al, 1991). If an opportunity is given, women can have a very important role in improving the standards of living of the developing countries. Making credit schemes where women can participate and are encouraged to do so is a way of making sure that the women's rights are implemented in the field.

Microcredit aims to ensure that the money is used in the right cause, and with a high rate of repayment. It appears that women respond more to discipline and take the social sanctions very seriously, in other regions too (Fong et al, 1991).

Due to the lack of formal services, women also recourse to other sources of lending such as relatives, friends (in which most of the time interest is not charged) and money lenders that charges very high rates per year. The main purposes of these loans are for consumption and emergency purposes. The advantages of the informal approach are the easier and faster accessibility to credit, collateral is not required for small loans and loan can be used for consumption as well. But long-term projects cannot be financed by this way.

Studies have proved that women do have an active participation in the decision process but when these schemes are implemented one needs to have attention to the cultural facts involved. Even when trust was gained, the bank had some problems with the workings of the groups. On the other hand, in Kenya where women have traditionally strong groups, the group loan method worked much better (Fong et al, 1991).

Due to lower levels of education, applying for a formal loan implies dealing with papers and people, and that is not only costly but also frightening for poor women. They see the informal money-lenders as more accessible. This is an area where an NGO could act. Not only helping people to deal with these issues, but also improving the literacy levels and transmitting new ideas in order to change the mentality needed for the success of these programs.

Traditional problems can be solved with imaginative and innovative ideas. The Grameen bank was the first major case and reproductions of its methods have been applied to other communities. In Nepal, the Agricultural

Development Bank has group organizers and women's group organizers. The former conduct surveys in order to understand the key points of forming groups, and the other teaches women and allows them to take loans to be used in an income-generating activity. In Morocco, the Credit Agricole of Morocco, created in 1961, has shown willingness to improve women's conditions towards credit. After having realized that their services were not been used as much as desired by women they implemented a questionnaire to see what the main reasons were. The answers only emphasized the problems stated above. They also found that the physical distance between homes and the branches were a factor together with the preference by women borrowers to deal with women staff. The bank simplified its procedures and brought the services closer to the villages, and also set up a special unit staffed by women. The Bank Rakyat of Indonesia, also helped women's situation with their small minimum size loan, simple loan application and standard products. Other modalities have also been implemented like the Self-Employed Women's Association Co-Operative bank in India whose immediate goal was to free women from the indebtedness of money-lenders.

Legal and political changes need to be made in certain regions in order to allow women's active participation in the credit market. Since one can argue that legal and political changes reflects the society's desires, the NGOs could have an important role in education and in allowing new ideas to be accepted by the population. In very extreme situations it might be better to have separates schemes for women, nevertheless we think that the mixed-group approach should in general be preferred. From the study of practical cases, it was proved that the rate of repayment of women is very high, and there is commitment to the use of the loan. As such women appear to be a good target not only for social reasons but also from the commercial point of view.

5 – Examples In Europe and America

Microcredit schemes are used all over Europe and in the US. They are used as a way of breaking the poverty cycle for the poorest people, and also have become increasingly attractive as a source of investment for those how look for new places to invest their extra money.

In December 2000, there was the *European Conference on " micro-credit "* in France, in which several cases from different countries in Europe were presented. This conference had the presence of members from the biggest private bank institutions, the European commission, World Bank, United Nations, the directors of the major European microcredit association, and many others[8].

In England, the Triodos Bank, one of Europe's leading ethical banks, has created several ethical investment funds related with environment, energy and social business. It won the 'Best Savings Account Provider' and 'Best ISA and Investment' in the 2001 Guardian and Observer Consumer Finance Awards, placing it ahead of all the high street banks and building societies.

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[8] For detailed information see: http://www.finances.gouv.fr/DICOM/manifestations/microcredit/table_ang.htm

In Germany, The Deutsche Bank, one of the biggest commercial banks, has "*establish the Deutsche Bank Microcredit Development Fund as a financial tool to fuel the growth and reach of microfinancing programs around the world. The fund provides loans to non-profit microfinance institutions or non-profits that are evolving into regulated entities. These loans are intended to provide equity-like debt that will be held by the microcredit institution on its balance sheet to assist in capitalizing its loan loss reserves, or to be used as collateral as part of obtaining a loan from a local financial institution on a leveraged basis. Loans from the fund are intended to leverage capital from local commercial financial institutions for direct lending, enabling the targeted microfinance programs to leverage conventional debt, grow their programs, and hopefully achieve the economies of scale needed to become self-sufficient. Since its inception, the Deutsche Bank Microcredit Development Fund has disbursed US$987,500 to MFIs around the world, which helped to finance some 170,507 microentrepreneurs in 2000*"[9].

In Portugal: The BCP bank has a crucial role on the success of the Portuguese Association for microcredit by promoting loans to those unable to have it through the formal markets. The Secretary of State for labor affairs also sees that the microcredit activities … "*have scope to grow, and that in Portugal should be significantly increased …*"[10]

In Spain: Un Sol Món Foundation is an entity created on February 2000 by Caixa Catalunya, within the framework of its Social Work, dedicated to economically promote the most underprivileged and excluded social collectives. The foundation aims, on the one hand, to offer technical and financial support to cooperation for the development of the Third World Countries and, on the other hand, to impel projects that fight in favour of the excluded collectives in our society, that means, the so-called Fourth World.

In the United States: In 1994, Congress and the US Agency for International Development (USAID) launched a Microenterprise Initiative. USAID committed to spend $140 million for microcredit in 1996, and promised that, by the end of 1996, half of all microcredit resources would be going to poverty lending programs. These programs are defined as those which serve the very poor, with loans under $300. USAID also committed to emphasize programs that reach women. In the same initiative, USAID created a "central fund" for microenterprise, which particularly supports non-governmental organizations (NGOs). "*Microcredit is the practice of extending small loans to people in poverty so that they can start small businesses and develop savings. A modest investment by the United States in microcredit for the poorest can have an enormous positive impact, especially if channeled through institutions with strong track records in administering microcredit programs and successfully targeting the poorest*"[11].

6 - Conclusions

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[9] http://www.swwb.org/English/1000/address/gnbi/add_gnbi_deutsche.htm

[10] Boletim da Associação Nacional de Direito ao Crédito, nº 12

[11] RESULTS, http://www.action.org/micro.html

Based on the experience and in the vast literature in microcredit, we believe that the bottom-up approach, that sees microcredit as a potential market, is a more efficient and productive approach. The alternative model developed in this paper proves the success of this view. Nevertheless, for that success be achievable, the proper legal and political environment has to exist. Defending the bottom-up view, we also think that some subsidy may be supplied initially, as a first push or primitive accumulation process. Even if initially, it was implemented a favorable interest rate, a careful and credible policy should make sure that rates achieve a market level very soon. At some stage the external help should be completely eliminated and the bank should be able to be sustainable. If this is not the case, then this is not a viable project and the long-term view has been forgotten.

If savings is one of the important variables in a macroeconomic model why should it be left out in the developing countries? Experience having demonstrated that the poor save money whenever possible, savings can be used as a fund for the ongoing lending and as a way of screening for the ability to deal with debt by the borrower.

The problem of collateral together with the formal obstacles for lending money to poor can be overcome by the use of joint-liability and peer monitoring. This method improves the repayment rate and the welfare of the borrowers by allowing them to obtain more loans at a lower rate.

The different levels of information between individuals will have a final impact on the success of the programs. We believe that when individuals do not know each other, the social links might have to be reinforced by alternative ways.

Individual lending should not be ignored. Even if the traditional collateral is not available, the importance is not the commercial value of the item, but the value that the borrower has attached to it. We believe that those items can be seen as good collateral. In some countries these loans are available and are profitable even if a closer auditing and monitoring has to be made by a bank officer. A good and efficient management is able to cope with it.

The techniques associated with the top-down approach of subsidization used in the past were main conception helping developing countries. More central power orientated countries will have to adapt for some liberation in financial regulations, as the own role of the NGOs and donors should be revised or reconsidered. Both the role of the NGOs and the donors are very much together. The money available should be used in modeling the environment, not only politically and legally, but also in the cultural and educationally point of view. Programs in which the role of the female is emphasized and where different religions or races might have to coexist, will only be successful if the target group accepts the other individual and can see that cooperation is positive for his welfare. This might take years, but the NGOs and the money from the donors could have an extremely important role in the change of these communities. This is a long-term approach.

Lending to women was also shown to be sustainable and desirable. The fear of social sanctions and the general obedience to rules, makes women's character attractive to credit. For this social emancipation to be possible some basic rules of certain countries need to be changed. This is where the NGOs and international organizations have a role to play. Effectively the role of women in the decision making process is quite high in the developing countries. Some of them need to accept that. Once this is achieved a whole new environment is implemented and a big part of these countries' problems will be solved.

We think, it is commercially possible to support ethical and welfare improving activities in the developing world. It is commercially sustainable to produce microcredit. Microcredit activities are economically sustainable and can be implemented by commercial banks with the use of the techniques expressed in this essay.

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